

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AGRE-00 CEA-01 CIAE-00 COME-00
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FM AMEMBASSY LISBON
TO SECSTATE WASHDC 5187

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 2188

DEPT. PASS TREASURY FOR STVRUD

E.O. 11652: GDS
TAGS: EFIN, ECON, PO
SUBJECT: PORTUGAL'S BALANCE OF PAYMENTS PROJECTIONS

REF: A) LISBON 2110 B) LISBON 2189

1. REF B PRESENTED THE EMBASSY'S TENTATIVE ESTIMATES AND PROJECTIONS FOR PORTUGAL'S 1977, 1978 AND 1979 BALANCE OF PAYMENTS. FOLLOWING IS THE COMMENTARY ON THOSE DATA.

2. TRADE: THE TRADE PROJECTIONS FORESEES, IN CURRENT TERMS, A GROWTH OF 4 PERCENT FOR IMPORTS, AND 10 PERCENT FOR EXPORTS IN 1978. THIS PROJECTIONS IMPLIES A REAL DECLINE IN IMPORTS OF ABOUT 1 PERCENT FOR THE YEAR. ANY FURTHER REDUCTION, WE BELIEVE, IS INCOMPATIBLE WITH THE GOVERNMENT'S 3 PERCENT GNP GROWTH TARGET. WE DISCOUNT AS UNREALISTIC THE GOP'S TARGET OF A 6 PERCENT DECLINE IN IMPORTS; A CUTBACK OF THAT MAGNITUDE WOULD REQUIRE A STAGNANT, AND PROBABLY DECLINING, GNP. OUR EXPORT GROWTH PROJECTION - 5 PERCENT IN REAL TERMS - MAY PROVE TO BE OPTIMISTIC, GIVEN THE EXPORT SECTOR'S STRUCTURAL PROBLEMS, UNLESS THE GOP ADOPTS A VERY AG-
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GRESSIVE EXPORT PROGRAM. TEXTILE EXPORTS, WHICH ACCOUNT FOR 25 PERCENT OF THE TOTAL, ARE STAGNANT. OTHER MAJOR SECTORS ARE IN A SIMILAR SITUATION. RAPID GROWTH INDUSTRIES - E.G., FOOTWEAR, FURNITURE - DO NOT APPEAR LARGE ENOUGH TO PROVIDE AN OVERALL REAL GROWTH EXCEEDING 5 PERCENT. A RISE IN EXPORTS ABOVE 5 PERCENT WOULD LIKELY NECESSITATE A SIGNIFICANT SHIFT FROM DOMESTIC TO EXPORT

MARKET, IMPLYING A VERY SHARP REDUCTION IN PERSONAL INCOME AND SERIOUS POLITICAL RISKS.

3. SERVICES: SERVICES COULD TURN POSITIVE BY 1979. THESE PROJECTIONS, HOWEVER, SHROUD TWO MAJOR PITFALLS. FIRST, THEY FORESEE A NET SUBSTANTIAL, THOUGH NOT EXAGGERATED, RISE IN TOURIST RECEIPTS. THEY OPTIMISTICALLY PRESUME THAT PORTUGUESE TOURISM IMPORT SERVICES WILL REMAIN LOW, WHICH IS CONSISTENT WITH ASSUMPTION OF FALLING PERSONAL INCOME. ON THE OTHER HAND, THEY SUGGEST THAT GROSS RECEIPTS WILL NOT ATTAIN 1973 LEVELS, IN REAL TERMS, UNTIL 1979. THESE FIGURES PRESUME THAT NO POLITICAL OR LABOR DISTURBANCES WILL FRIGHTEN POTENTIAL VISITORS. SECOND, INVESTMENT INCOME'S NEGATIVE BALANCE HAS ALREADY REACHED UNCOMFORTABLE LEVELS AND COULD WORSEN. THE FOREIGN DEBT HAS RISEN RAPIDLY, WILL CONTINUE TO GROW, AND INTEREST RATES MAY RISE. EACH OF THESE FACTORS IMPLY AN EVEN LARGER INTEREST BURDEN. IN ADDITION, MANY PRIVATE FOREIGN INVESTORS ARE HOPING TO UTILIZE THEIR IMPROVING LIQUIDITY POSITION TO REMIT PROFITS. BANK OF PORTUGAL MIGHT PARTIALLY RESTRAIN SUCH REMITTANCES THROUGH EXCHANGE CONTROLS, BUT AT THE RISK OF DISCOURAGING NEW FOREIGN INVESTMENTS AND ENCOURAGING CAPITAL FLIGHT. THE ONLY ACCEPTABLE POLICY IS TO PROMOTE CONFIDENCE, THEREBY STIMULATING REINVESTMENT RATHER THAN EXCESSIVE PROFIT AND SERVICE REMITTANCES. CONFIDENTIAL

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4. TRANSFERS: THE EMBASSY'S PROJECTION FOR EMIGRANT REMITTANCES ARE, ADMITTEDLY, SOMEWHAT CONSERVATIVE. THESE TRANSFERS COULD GROW AT A FASTER PACE, BUT NOT UNDER PRESENT CONDITIONS. PRELIMINARY DATA, FOR EXAMPLE, INDICATE THAT TRANSFERS IN JANUARY 1978 WERE THE SAME AS IN JANUARY 1977 IN DOLLAR TERMS. FOR THESE TRANSFERS TO GROW MORE RAPIDLY, THE EMIGRANT PERCEPTION OF PORTUGAL MUST CHANGE AND CAPITAL FLIGHT, MUCH OF WHICH FINDS AN OUTLET BY PRE-EMPTING POTENTIAL TRANSFERS, MUST DIMINISH.

5. CURRENT ACCOUNT: THE PROJECTIONS STRONGLY SUGGEST THAT EVEN IF PORTUGAL SUCCEEDS IN PROMOTING TOURISM, STIMULATING EMIGRANT REMITTANCES AND CUTTING IMPORTS, IT IS UNLIKELY TO PRODUCE A MARKED IMPROVEMENT IN THE CURRENT ACCOUNT OVER THE SHORT TERM. ONLY A PROMPT

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C O N F I D E N T I A L SECTION 2 OF 2 LISBON 2188

DEPT. PASS TREASURY FOR STVRUD

RECOVERY OF AGRICULTURE, A NEW VIGOR IN INDUSTRY, A RELATIVELY SHARP DROP IN ENERGY IMPORTS, ETC. WOULD BE ABLE TO PRODUCE THE NECESSARY CURRENT ACCOUNT IMPROVEMENT. NONE OF THESE DEVELOPMENTS, HOWEVER, SEEMS LIKELY. THUS GOP POLICIES WOULD PROBABLY HAVE TO IMPOSE A TRULY DRASTIC REDUCTION IN PERSONAL INCOME TO ACHIEVE THIS ECONOMIC RESULT. ITS ABILITY TO DO SO, WITHIN THE PRESENT POLITICAL/SOCIAL CONTEXT, IS LESS THAN DOUBTFUL.

6. CAPITAL ACCOUNT: OVER THE SHORT TERM, PORTUGAL WILL HAVE TO IMPROVE ITS CAPITAL ACCOUNT MARKEDLY. IT MUST, FIRST OF ALL, SERIOUSLY DISCOURAGE CAPITAL FLIGHT. NO POLICY MIX IS LIKELY TO ELIMINATE CAPITAL FLIGHT COMPLETELY, AT LEAST OVER THE MEDIUM TERM, BUT IT COULD REDUCE THE DRAIN SUBSTANTIALLY. NEXT, THE GOP MUST ATTRACT MORE MEDIUM AND LONG TERM CAPITAL RATHER THAN CONTINUING ITS RELIANCE ON SHORT-TERM FINANCING. A FURTHER SUBSTANTIAL INCREASE IN SHORT-TERM INDEBTEDNESS WOULD CRATE TOO HEAVY A BURDEN AND WOULD EXPOSE THE ECONOMY TO SUDDEN, SHARP MOVEMENTS EACH TIME A DOMESTIC CRISIS THREATENED. THUS THE EMPHASIS MUST
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SHIFT TO LONGER TERM FINANCING, AND ESSENTIALLY FINANCING THAT EXPANDS EXPORT EARNINGS WITHIN THE SHORTEST POSSIBLE TIMEFRAME. FINALLY, PORTUGAL WILL HAVE TO ATTRACT RELATIVELY LARGE DIRECT FOREIGN INVESTMENTS,

PREFERABLY IN SECTORS THAT EARN OR AT LEAST SAVE FOREIGN EXCHANGE. SOME PORTUGUESE MAY REGARD SUCH A POLICY AS A DENATIONALIZATION OF DOMESTIC ASSETS, BUT IT MAY BE THE ONLY ALTERNATIVE TO CUTTING PERSONAL INCOME DRASTICALLY.

7. THE EMBASSY RECOGNIZES THAT ITS 1978 AND 1979 CAPITAL ACCOUNT PROJECTIONS ARE DEBATABLE. THEY ASSUME, FOR EXAMPLE, THAT THE GOP WILL ROLL-OVER SOME ONE BILLION DOLLARS IN DEBTS TO THE BIS AND EUROPEAN CENTRAL BANKS IN 1978. PROSPECTS FOR SUCH A ROLL-OVER ARE QUITE GOOD, ESPECIALLY IF THE GOP CONCLUDES A SECOND TRANCHE IMF ACCORD. THE EMBASSY'S ASSUMPTION THAT THE GOP WILL SEEK TO REPAY THE DEBTS DURING 1979 - 1981 IS MUCH MORE UNCERTAIN. SIMILARLY, NO ONE CAN REALLY PREDICT THE SPEED AT WHICH PORTUGAL WILL DRAW DOWN ITS WORLD BANK, EFTA, AND EC CREDIT LINES. FINALLY, THE EMBASSY HAS INCLUDED A RELATIVELY LOW LEVEL OF GOLD SALES FOR 1978 AND SALES FOR 1979. IT DID SO IN THE BELIEF THAT PORTUGAL WILL TEND TO SHEPHERD THESE ASSETS IN ORDER TO SAFEGUARD ITS SHORT-TERM DEBT POSITION. IF THE INTERNATIONAL GOLD PRICE CONTINUES ITS DECLINE OF THE PAST WEEK, MORE-OVER, PORTUGAL'S ABILITY TO SELL WITHOUT DAMAGING FOREIGN CONFIDENCE WILL BE SERIOUSLY REDUCED. BUT EVEN IF THE GOP CAN CONTINUE SELLING, OUR TENTATIVE PROJECTIONS CLEARLY INDICATE THAT PORTUGAL'S FUTURE EXTERNAL DIFFICULTIES ARE AWESOME.

BLOOMFIELD

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